

**CHIEF AUDITOR'S REPORT
JUNE 2007**

Attachment A

SUBJECT	DATE OF ASSIGNMENT	STATUS
1. Biennial Audit Plan	June 2006	The Board of Administration approved the Audit Plan for Fiscal Years 2006-07 and 2007-08 upon recommendation by the Finance Committee at the June 21, 2006 meeting. A quarterly status report showing all progress towards completion of the Biennial Audit Plan as of March 31, 2007 is included as Item 4 of this agenda.
2. Auditor Classification Study	March 2007	The project team is analyzing the data to compare CalPERS' specific auditor classification relative to other agencies such as the Department of Finance and the Bureau of State Audits. Review of the analysis will be performed by CalPERS' Human Resources Division. The results of the study will be presented to the Finance Committee at the September 7, 2007 meeting.
3. Real Estate Auditor – International Investments	April 2007	The Chair directed staff to provide a report detailing what real estate audit firms have offices at international locations where CalPERS currently owns property. Attachment B of this Agenda Item the illustrates international real estate investments held by CalPERS and which real estate auditor in the pool either has an office or association of independent accounting firms in the various countries. CalPERS has the ability to provide audit coverage of all international real estate investments.
4. Real Estate Auditor – Contract Manager Protocols	April 2007	The Chair directed staff to develop protocols for selecting real estate auditors from the spring-fed pool. Staff developed criteria for selecting audit firms for particular engagements as illustrated in Attachment C of this Agenda Item. Initial assignments are based on areas of expertise, no conflict of interest, and location. Subsequent assignments will consider quality of work, efficiency, cost effectiveness, and performance.
5. Monitoring and Responding to Exposure Drafts and Proposals	Ongoing Workload	<u>Public Company Accounting Oversight Board (PCAOB)</u> In May, the PCAOB voted to issue a final standard on auditing internal control over financial reporting (ICFR), as well as a related independence rule and conforming amendments to the Board's interim auditing standards. The new standard, Auditing Standard No. 5, <i>An Audit of Internal Control over Financial Reporting Performed that is Integrated with an Audit of Financial Statements</i> , supersedes Auditing Standard No. 2 (AS2).

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5. Monitoring and Responding to Exposure Drafts and Proposals (cont.)	Ongoing Workload	<p>The new auditing standard (AS5) is focused on maintaining the benefits investors have received from improved financial reporting. The new standard is intended to raise the auditor's "line of sight" and focuses the attestation process on obtaining reasonable assurance that a material weakness does not exist. The standard applies to all companies, irrespective of size, that need to comply with Section 404. Although the principles from AS2 have been retained, the PCAOB staff pointed out during the meeting that the magnitude of change in the new standard should not be underestimated.</p> <p>During the meeting, the PCAOB staff outlined the following changes made to the proposed standard:</p> <ul style="list-style-type: none"> • Align the PCAOB's audit standard with the SEC's interpretive guidance for management regarding the process for evaluating and assessing ICFR • Differentiate between management's assessment process and the auditor's attestation process • Reduce the number of prescriptive requirements thus allowing the auditor to use judgment in applying a top-down approach • Provide additional guidance on entity-level controls • Clarify the requirement for walkthroughs • Integrate the discussion around scaling the audit for size and complexity • Eliminate the proposed auditing standard, <i>Considering and Using the Work of Others in an Audit</i>, which would have superseded previous standards. <p>Other changes include the elimination of the requirement for the auditor to assess and give an opinion on management's evaluation process and refocusing the multi-location scoping process to address the quality of evidence, not the quantity.</p>

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5. Monitoring and Responding to Exposure Drafts and Proposals (cont.)	Ongoing Workload	<p><u>Securities and Exchange Commission (SEC)</u></p> <p>In May, the SEC agreed to publish in final form the interpretive guidance for management regarding its evaluation and assessment of internal control over financial reporting (ICFR). Based on the comments received, the SEC staff recommended that the guidance be issued as an interpretation (as opposed to a rule) so that it can be more easily modified and enhanced over time. In addition to the interpretive guidance, the SEC approved the following actions:</p> <ul style="list-style-type: none"> • Adopt amendments to Exchange Act Rules that would make it clear that an evaluation that complies with the Commission's interpretive guidance would satisfy the annual management evaluation required by those rules. • Adopt amendments to Rules of Regulation to require the expression of a single opinion directly on the effectiveness of ICFR by the auditor in the attestation report. • Adopt amendments to Exchange Act Rule to define the term, "material weakness." The SEC defines a material weakness as "a deficiency, or combination of deficiencies, in ICFR such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis." • Propose an amendment to Exchange Act Rule to define the term, "significant deficiency." Many commenters asked that the SEC define this term. To preclude management from having to look up the definition in an auditing standard and in view of the Section 302 requirement that certifying officers disclose material weaknesses and significant deficiencies to the audit committee and the auditor, the SEC has agreed to define the term. The Commission intends to begin the process by issuing a proposal for public comment. The proposed definition will apparently not include a probability threshold and will focus exclusively on severity.

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<p>5. Monitoring and Responding to Exposure Drafts and Proposals (cont.)</p>	<p>Ongoing Workload</p>	<p><u>Governmental Accounting Standards Board (GASB)</u></p> <p>On May 31, 2007, the GASB issued Statement No. 50, <i>Pension Disclosures</i>, which more closely aligns current pension disclosure requirements for governments with those that governments are beginning to implement for retiree health insurance and other post-employment benefits.</p> <p>Specifically, Statement 50 amends GASB Statements No. 25, <i>Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans</i>, and No. 27, <i>Accounting for Pensions by State and Local Governmental Employers</i>, by requiring:</p> <ul style="list-style-type: none"> • Disclosure in the notes to the financial statements of pension plans and certain employer governments of the current funded status of the plan—in other words, the degree to which the actuarial accrued liabilities for benefits are covered by assets that have been set aside to pay the benefits—as of the most recent actuarial valuation date. • Governments that use the aggregate actuarial cost method to disclose the funded status and present a multi-year schedule of funding progress using the entry age actuarial cost method as a surrogate; these governments previously were not required to provide this information. • Disclosure by governments participating in multi-employer cost-sharing pension plans of how the contractually required contribution rate is determined.

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5. Monitoring and Responding to Exposure Drafts and Proposals (cont.)	Ongoing Workload	<p>The Governmental Accounting Standards Board (GASB) announced on April 6, 2007 that it has added a project to its current agenda that could result in suggested guidelines for governments to help them effectively communicate their accomplishments to the public.</p> <p>Specifically, the project, known as Service Efforts and Accomplishments (SEA) Reporting, will help governments report the measures they develop and use to gauge the outcomes they achieve in pursuit of their public policy goals. For example, if a government has a goal of increasing high school graduation rates, SEA reporting could help the government to inform the public about its progress toward that goal.</p> <p>More than two decades of GASB research show that SEA reporting provides important information that can help citizens and their elected representatives better assess how well their governments are achieving their public policy missions. It is important to note that the SEA Reporting project is designed to produce suggested guidelines for voluntary reporting by governments.</p> <p>Accordingly, the GASB does not intend to require governments to report SEA information, nor does it intend to require that governments report specific performance measures or achieve specific levels of performance. Instead, the GASB will consider establishing guidelines that will help government officials communicate performance results that are relevant to their expressed priorities and goals in a manner that the public will find meaningful and understandable.</p>
6. Reportable Significant / Material Findings	Ongoing Workload	No new issues to report.